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Summary:

Westminster, Colorado; Water/Sewer

Primary Credit Analyst:

Malcolm N D'Silva, Centennial + 1 (303) 721 4526; malcolm.dsilva@spglobal.com

Secondary Contact:

Melody W Vinje, Centennial + 1 (303) 721 4163; melody.vinje@spglobal.com

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Summary:

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Credit Profile

US\$17.89 mil wtr and wastewtr rev rfdg bnds ser 2020 due 12/01/2039

Long Term Rating

AAA/Stable

New

Westminster wtr & wastewtr

Long Term Rating

AAA/Stable

Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to Westminster, Colo.'s series 2020 water and wastewater revenue refunding bonds. At the same time, we affirmed our 'AAA' rating on the city's existing water and wastewater revenue bonds. The outlook is stable.

The city is issuing the series 2020 bonds to refund certain revenue bonds previously issued by the city for annual debt service savings. Post-issuance, the city will have approximately \$135 million of outstanding water and wastewater revenue debt obligation. We view the bond provisions as adequate and credit neutral. The bonds are secured by a senior lien on the net revenues of the city's water and wastewater enterprise system. Covenants include an additional bonds test set at 1.2x annual debt service, and a rate covenant set at 1.1x annual debt service. We understand that the city does not intend to provide a debt service reserve fund for the series 2020 bonds, however, the system's financial profile, including extremely strong liquidity, precludes any credit risk.

Credit overview

The rating reflects our opinion of the water and wastewater utility enterprise system's general creditworthiness and a combination of its extremely strong enterprise and financial risk profiles. The strength of the utility enterprise financial metrics provides a strong cushion to mitigate short-term disruptions from the COVID-19 related recession.

S&P Global Ratings acknowledges a high degree of uncertainty related to the impacts of COVID-19, including the rate of spread and peak of the outbreak. We believe measures to contain COVID-19 have pushed the economy into recession. We believe the system's revenues may decline somewhat for fiscal 2020 or beyond, though ultimately our expectation is that management will continue to manage the system and maintain strong coverage levels. The system, as of fiscal 2019, also has over two years cash on hand, which we believe provides sufficient cushion for short-term disruptions. Additionally, management has instituted its contingency plans to ensure minimal disruptions in service provided. While we continue to monitor events related to COVID-19, we do not currently anticipate it to materially affect the system's ability to maintain budgetary balance and make debt service payments. Our revenue rating also reflects our assessment of the enterprise system's operations, the specific security, and the legal protections in place. However, we also consider the influence of external factors including the potential for extraordinary support or intervention from the related government. We believe that the utility has sufficient autonomy to raise rates and also historically there have been minimal transfers to the general fund relating to overhead costs. Management reported

that there are no plans to impose any additional costs on utility enterprises to supplement general fund revenue.

The stable outlook reflects our expectation that the system will continue to produce extremely strong financial metrics, characterized by extremely strong all-in DSC and liquidity as the city progresses through its large CIP. During the two-year outlook period, we anticipate that management will continue to address future rate adjustments in a phased manner in order to preserve the system's financial profile and meet pay-as-you-go capital requirements. In addition, we believe the extremely strong financial profile could withstand a short-term decline in revenue from changing economic conditions, particularly uncertainty related to COVID-19, and the recession.

The utility system's extremely strong enterprise risk profile includes:

- Growing service area with strong income indicators located in the larger Denver metropolitan regional economy;
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Affordable service rates in the context of the service area's strong income levels, and recent rate adjustments; and
- Good operational management practices and policies with ample water supply and a focus on replacing its existing water treatment plant, and continued water supply planning to provide for future water security.

The utility system's extremely strong financial risk profile includes:

- Extremely strong history of all-in debt service coverage (DSC) that is projected to continue, given recent rate adjustments to meet future annual debt service costs;
- Extremely strong liquidity that we expect to be sustained through the planned CIP, but could be modestly drawn down based on the timing of near-term capital spending;
- Low leverage position based on a pro forma debt-to-capitalization ratio of about 22% when accounting for additional debt financing plans through 2020; and
- Strong financial management assessment (FMA) of its practices and policies that include long-term financial and capital planning.

Westminster's water and wastewater utility has a predominantly locally derived revenue base. Local service charges, derived through an autonomous rate-setting process, represent virtually all of the entity's revenues. This, coupled with operating expense flexibility, limits exposure to federal revenues.

Environmental, social, and governance (ESG) factors

Overall, we believe that management has mitigated most of the water system's ESG-related risk by adopting, adhering to, and adjusting its operating and financial policies and procedures. Westminster is currently addressing aging infrastructure issues and is also working on enhancing its water supply as part of its strategic priorities. As a result, the city's utility department has a current large capital improvement program (CIP) to address long-term planning effort for several projects, which includes replacement of the Semper Water Treatment Plant (50 years old), repair and replacement of a large sewer interceptor with a potential for capacity increase, and implementation of the city's water supply augmentation strategy by enhancing water security and improving system reliability and resiliency. The city's Semper water treatment plant replacement project is known as the "Water 2025 Program" and we view the city utility management team as strong, which mitigates governance risks compared to peers. Officials are working on a financial

plan to provide a framework for making a number of investments across its facilities and distribution network to reduce the system's environmental risks. Water 2025 provides a framework for a multi-year phased implementation of the new water treatment plant, with a gradual phase-out of the existing Semper water treatment plant through 2040, thereby spreading the costs of the replacement facility over time. In October 2018, the city completed a cost-of-service rate study, and the city council approved a two-year rate plan through fiscal 2020 with significant revenue adjustments to support the CIP. Given recent history of rate increase approvals, we view the city as having rate-making flexibility needed in order to preserve the system's financial position and meet future cost-of-service requirements. We understand the system will continue recommending updates to its future rate plans to meet revenue sufficiency in the near future, and we do not believe this will significantly increase affordability pressures or social risks, given the monthly combined bill is only 1.9% of local income levels.

Stable Outlook

Downside scenario

We do not anticipate lowering the rating over our outlook horizon as long as the system continues to produce financial metrics that are consistent with or exceed historical trends while successfully funding its capital plan. However, we could lower the rating, if there is an unanticipated and extraordinarily large change in the CIP that could alter related financial metrics, including significant spend down of unrestricted reserves. Moreover, we could lower the rating, if financial metrics are no longer consistent with the rating level, as a result of the dampening effects of the COVID-19 pandemic on economic activity and the recession.

Credit Opinion

Enterprise risk

Our assessment of the system's enterprise risk profile is extremely strong and reflects our view of the city's strong economic fundamentals including participation in a broad and diverse metropolitan statistical area (MSA), affordable service rates combined with strong income levels, and good operational management framework.

Westminster (with an estimated population of about 113,875) is located about 10 miles northwest of downtown Denver, within both Adams and Jefferson counties. Residents have access to employment throughout the broad and diverse Denver MSA. The city's income levels are strong, in our view, with median household effective buying income at 129% of the national average. We anticipate that the city's economy will likely remain stable given that it continues to see ongoing growth from commercial and residential developments. In the future, as the city approaches build-out (roughly anticipated to be around 2040), we understand that continued water supply development and utility system capacity upgrades will be required to ensure support for expansion in currently undeveloped portions of the service area. The customer base has been growing steadily, and is primarily residential, and very diverse. The system serves approximately 33,087 water and 31,575 wastewater customer accounts as of 2018. We consider the customer base to be primarily residential based on residential customers making up approximately 90% of customer accounts. The customer base is, in our view, very diverse, with the 10 leading customers accounting for about 11% of total service charge revenues.

The city's water supply comes largely from Standley Lake (the city owns 22,500 acre-feet or 52% of storage), which receives snowmelt runoff. The city also has reclaimed water and supply from water rights exchanges. The city believes it will have adequate supply for its projected built-out population as identified by its long range master plan studies. The city owns water rights to use Standley Lake to store water from Clear Creek, Coal Creek and the Fraser River. The city also has secured water rights to exchange lower quality water released from downstream reservoirs for additional high quality water diverted to Standley Lake. Water is currently treated at two city-owned treatment plants (Semper Water Treatment Plant and Northwest Water Treatment Plant). Wastewater is treated at either a city-owned treatment plant or at the Metropolitan Wastewater Reclamation District's (Metro) treatment facilities, depending on customer location. About 75% of customers are served by the city facilities, and 25% are served by Metro pursuant to a perpetual service contract. The city's wastewater treatment plant has a design capacity of 9.8 million gallons per day (mgd). Average daily flow was about 6.6 mgd in 2019.

We view the system's market position as very strong based on its affordable retail service rates, particularly relative to the service area's strong income levels. In October 2018, the city council approved the current two-year rate plan with a 10% revenue adjustment in 2019 and 2020 for water; and a 16% (for 2019) and 12% (for 2020) revenue adjustment for wastewater services. The currently approved rate structure is composed of a fixed monthly charge, and volumetric consumption charge based on an adjusted usage-based rate tiers (for water) after taking into consideration revenue requirements and cost-of-service for each customer class. We calculate an average monthly-equivalent combined bill of approximately \$102 (in 2020), or about 1.9% of MHHEBI when annualized, which we consider affordable. The fixed monthly base charges for 2019 and 2020 reflect the first two years of an eight-year phase-in period, which is designed to meet a new set of integrated policies, including adjusting existing residential and commercial customer imbalance, and increasing the revenue contribution made by monthly fixed charges to approximately 20% of total service charge revenue. We consider the rate restructuring to generally be credit neutral given the relatively balanced fixed component, which we believe insulates revenues in periods of drought and lower consumption.

We consider the system's operational management to be good under our operational management assessment methodology, which indicates a favorable alignment of operations and organizational goals, even if some challenges exist. We also believe that environmental, social, and governance principles are generally well aligned with the system's core mission, and planned water supply augmentation strategy. The water and sewer system has ample capacity for average and peak demand, and given the stable customer growth, management estimates the system has ample capacity to meet future needs. Rates are reviewed and approved biannually. In addition, the city's utility strategic plan (reviewed annually) and conservation plan are in place to sustain strong operations. We understand that a significant effort of the system's CIP is related to the Water 2025 Program which includes the replacement of the existing Semper water treatment plant, including a substantial upgrade to the treatment process. The system is also acquiring advanced metering infrastructure to replace aging meters, reduce maintenance costs and improve customer service. The city has broadened its public outreach to customers relating to utility strategies and long-term needs. The city has also established an integrated water supply plan and comprehensive land use plan, which lays out a strategy to provide a dependable supply of high quality water to the city's service area at planned build-out of the system.

Financial risk

Our assessment of the system's financial risk profile as extremely strong reflects the city utility's extremely strong all-in coverage, extremely strong liquidity position, low leverage position with planned funding for capital needs, and strong financial management framework.

The system's financial performance has been extremely strong in recent years, and we anticipate this to continue in the near future despite new money debt financing for capital needs. In 2018 (the latest audited year), operating revenues totaled approximately \$60 million, up by an aggregate 32% from 2014 due in part to rate adjustments and growth in customers. Operating expenses, excluding depreciation, were up by an aggregate 26% in 2018, totaling \$38 million during the same period. For fiscal 2019 (unaudited), despite a 10% decrease in water demand, operating revenues increased by about 6% over 2018 revenues, due in part to rate adjustments. Growth-related tap fees have also been a significant source of revenues in recent years and averaged about \$14 million (or approximately 16% of total revenues). Based on the city's financial statements, we calculate that all-in debt service coverage (DSC), including senior, subordinate-lien debt service, and take-or-pay minimums, was over 2.8x in the past three fiscal years. Even excluding growth-related tap fee revenue, all-in DSC was still extremely strong at over 1.6x in the past three years. Based on the city's biennial budget and projections, we calculate all-in DSC would continue to be over 1.6x in the near future, even under more extreme scenarios that extends a potential reduced demand through the two-year outlook period. The anticipated \$30 million state loan financing (from the Colorado Water Resources & Power Development Authority) in May 2020 would increase annual debt service costs; however, we view the city's system as having strong financial flexibility to meet future cost-of-service requirements.

We view the system's leverage position to be low based on a pro forma debt-to-capitalization ratio of about 22% in 2020. For the system's subsequent rolling five-year capital planning cycle through 2025, management estimates approximately \$340 million in capital needs, which will be about 50% debt financed. Given the scope of the long-term CIP, we believe the system's leverage position will increase in the near future, but not to levels that we would consider a constraint on the system's financial flexibility.

The utility system fund's liquidity position is extremely strong, in our view. Unrestricted cash and investments totaled about \$100 million as of Dec. 31, 2018, representing about 2.7 years of operating expenses on hand when excluding the storm water funds. The utility fund had approximately \$81 million in unrestricted cash and investments, or slightly over two years, when also excluding capital reserves. For fiscal 2019 (unaudited), the liquidity position is estimated to be at similar levels to 2018. Based on the system's CIP, we understand that it plans to deploy capital reserves to supplement its capital needs. However, we anticipate relatively nominal draws on internal operating cash to fund future capital projects, and we anticipate management will continue to maintain sufficient liquidity to meet operations. We understand the system typically targets rate stabilization reserves at about 25% of water rate revenues and 10% of wastewater revenues (based on budgeted annual revenues), and a capital reserve minimum balance target at \$3 million for the water fund and \$2 million for the wastewater fund.

Also supporting the financial risk profile is a strong FMA. This indicates that, in our view, the financial practices are strong, well embedded, and likely sustainable. The management team in our view maintains most of the best practices deemed critical to supporting credit quality and these are well embedded in the system's daily operations and practices. Examples include regular budget monitoring and reporting to the city council, existence of long-term

financial and capital planning, formal debt and investment policies, and a formal liquidity policy.

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